



Economic Research
& Planning Division

Financial Markets

Friday

October 19, 1979

The chaos that prevailed last week gave way to simple confusion this week, with the credit markets still pondering the implications of the Federal Reserve's recent policy measures. Over the longer run, the shift from Fed funds to reserves as the key monetary policy lever should improve monetary control and enhance the prospects for cooling down U.S. inflation, a potential plus for the bond markets. But it will take a while for the Fed to convince the markets of its intent to steadfastly pursue restraint, regardless of the approach.

And for now, the new tactics will mean higher and more volatile short-term financing costs. Moreover, with market participants still trying to figure out how the Fed will conduct its day-to-day operations under the new procedures, there was little retail or professional interest in holding bonds. Prices did stage a brief rally early in the week, as traders cashed in on existing short positions and pushed up prices. But market intervention by the Fed that signaled higher money market rates plus new evidence of a stronger than expected economy were enough to stall the advance, and prices ended the week off by a few more points. At the long end of the government market, the price drop pushed yields to 10% for the first time this year.

Credit tightening came on Thursday afternoon when the Fed sold Treasury bills outright. Until then, Federal funds had traded in the 13 1/4%-3/8% range, but following the reserve-absorbing move, funds ended up hovering around the 14% level. Under the Fed's new procedures it is not clear exactly what triggered the Fed's decision to tighten. But the money indicators continued to surge, and gains of \$2.8 billion for M1 and \$4.5 billion for M2 dampened market expectations (hopes?) of an October slowdown in monetary expansion. In addition, several of the major reserve indicators--total reserves, nonborrowed reserves, and the monetary base--have been expanding at very rapid rates over the past month, and bank borrowing at the discount window picked up substantially this past week. Whatever the immediate cause, it was evident that the Fed was willing to tolerate at least a 14% Federal funds rate.

The markets also interpreted the latest economic news as reason to expect further restraint. After dropping in August, industrial production rebounded at a 6.0% annual rate in September, and housing starts rose last month to almost 1.9 million starts at an annual rate. In the wake of these results and earlier reports of strengthening retail sales, it was not too surprising that real GNP, led by a revival in consumer spending, registered a 2.4% annual increase in the third quarter. The economic turnaround makes it clear that a recession, while on the way, has not yet arrived and gives the credit authorities still more time and justification for maintaining monetary restraint.

Glenn C. Picou

Money Market Rates

**Irving Trust
Company**

**A Charter
New York Bank**



	10/19/79 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	14.50%	14.50%	10.00%
Effective since	10/9/79		
Discount Rate at Federal Reserve Bank	12.00	12.00	8.50
Federal Funds	13.75	12.88	9.06
Repurchase Agreements	12.25	12.00	8.45
U.S. Treasury Issues - Yields			
Bills			
3 months	12.75	11.80	7.75
6 months	13.25	12.20	9.05
1 year	12.60	12.40	9.15
Coupons			
2 years	12.10	11.25	8.85
4 years	11.15	10.55	8.58
7 years	10.70	10.35	8.64
10 years	10.60	10.18	8.66
Long Bond	10.00	9.80	8.69
Negotiable Certificates of Deposit-Secondary Market			
1 month	13.75	13.50	9.00
3 months	14.15	13.70	9.60
6 months	14.50	13.90	10.00
1 year	13.75	13.25	10.00
Bankers' Acceptances			
1 month	13.75	13.50	9.15
3 months	14.50	13.90	9.50
6 months	14.80	14.30	9.60
Eurodollar Deposits			
1 month	14.00	14.63	9.25
2 months	14.63	14.81	9.69
3 months	14.88	15.00	10.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	12.00	12.75	8.55
1 month	13.25	13.00	8.90
3 months	12.75	12.50	9.00
Bank Holding Companies			
1 month	13.13	13.00	8.90
Dealer Placed:			
3 months	13.38	13.50	8.97
New Aa Corporate Utility Bond	11.25	11.15	9.25
Tax Exempt			
6 month Project Notes	5.90	5.90	4.20
12 Month Project Notes	5.75	5.75	4.60
20 year AAA Bond.	6.95	6.75	5.80

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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